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091052Z Jun 05

UNCLAS SECTION 01 OF 03 COLOMBO 001031

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DEPT FOR SA/INS; MCC FOR D.NASSIRY; TREASURY FOR C. CARNES

SENSITIVE

E.O. 12958: N/A

TAGS: [EAID](#) [ECON](#) [EFIN](#) [CE](#)

SUBJECT: GSL AIMS FOR MID-SUMMER MCA COMPACT PROPOSAL
FOLLOWING REVIVED CONSULTATIONS

1. (SBU) Summary: The Government of Sri Lanka (GSL) has begun to use provincial-level meetings to form local steering committees to review the GSL's Millennium Challenge Account (MCA) Concept Paper and provide feedback to the Finance Ministry. The process has largely been an effort to get validation of the Government's main priorities, though it does offer the local representatives an opportunity to raise other ideas for projects to spur economic growth. Comments during the initial organizational meetings have ranged from interest in pet projects, with only tangential relevance to the key question of economic growth, to skepticism about one of the concept paper's main projects - the rehabilitation of rural irrigation reservoirs. We expect this latest stage of the consultative process to last through mid-June, and expect the GSL to formulate its compact proposal by sometime in August. Overall, Post has been disappointed in the GSL effort at consultations, but hopes this latest effort serves to better inform their compact proposal. We are highly dubious of the irrigation rehab project, though there may be scope to use it to spur other needed agriculture sector reforms. We do believe the effort on the part of the business community to press for small and medium enterprise (SME) development programs, however, merits further scrutiny. End Summary

Provincial-level Consultative Process

2. (SBU) Following a lackluster initial effort to develop a concept paper for its MCA proposal, and the intervening tsunami, which sidetracked most normal Government

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operations for the better part of four months, the GSL has commenced island-wide meetings to discuss the concept paper presented to the Millennium Challenge Corporation (MCC) and further develop its compact proposal.

3. (U) The plan involves provincial-level meetings conducted by the Department of Development Finance (DDF) of the Ministry of Finance. A wide cross section of provincial level representatives is invited to these meetings including government officials, provincial council members, politicians, NGO representatives, academics from regional universities, and regional chambers. These meetings are used to form provincial steering committees, which are responsible for conducting additional meetings to review the concept paper, discuss economic problems in the area and draft submissions for consideration by the national steering committee in Colombo. The provincial chief secretary, who is a GSL civil servant, chairs the steering committee in each province.

4. (SBU) Already, the DDF has held six initial meetings in the following provinces: Central, North Central, Wayamba, Sabargamuwa, Uva and Western Provinces. Emboffs have attended two of the meetings. There were approximately 100 participants at each meeting. The meetings have provided information on the MCA (its intentions, requirements, and country selection) and the initial concept paper presented by the GSL, and appointed steering committees to continue discussions at the provincial level. The meetings appear to be used primarily to ask for advice to fine tune existing project proposals, rather than discuss problems and approaches to solving underlying challenges to economic growth. For example, the GSL's approach tends to be one of asking leading questions such as "which irrigation reservoirs are most in need of repair" or "which roads should we repair to give the greatest local benefit?"

5. (U) While these initial provincial-level meetings are not consultations, but planning meetings to start provincial level discussions, the audiences have mostly sought clarifications about the MCA program and funding opportunities. In the two meetings Post attended, participants mostly inquired about funds for projects related to their personal interests. For example, one person asked if funds would be available for housing; another, a medical practitioner, proposed assistance to

improve the availability of health-related personnel, while a youth activist asked if funds could be used to build recreational facilities. All suggested that their programs could have indirect benefits to economic growth.

16. (SBU) Unfortunately, the meetings do not appear to have been used to discuss fundamental issues like economic constraints in each province, reasons for persistent poverty or how best to overcome such problems. We expect the appointed steering committees to look into these questions.

Perceptions from Meeting Participants

17. (SBU) During the meetings, Emboffs had the opportunity to meet civil servants from the provinces, with wide ranging experience working in rural districts. As for the GSL's favored irrigation reservoir rehabilitation program, the Provincial Planning Secretary for Sabaragamuwa province told Emboffs that supplying water to farmers in her area would not do much to lift farmers out of poverty. Subsistence farmers who have small plots and engage in low-tech farming methods do most of the farming in the area. She said that unless steps are taken to resolve land problems and improve agricultural productivity, an irrigation rehabilitation program alone would not substantially increase economic growth. Such a limited program would more likely promote continued subsistence farming.

18. (SBU) The Planning Secretary also noted that although the Sabaragamuwa province is endowed with many natural resources, such as scenic locations, rainforests and waterfalls, such locations have not been developed as tourist attractions. Developing those locations and providing road access might be more useful for diversifying the local economy and promoting broader based growth. We also heard similar sentiments from a divisional secretary of the Central province. He suggested vegetable farmers in his area would benefit from a new highway connecting the district to business centers.

Next Steps

19. (U) The Finance Ministry expects to receive provincial comments on the MCC proposal by mid-June and hopes to submit a revised proposal to MCC in July or August 2005. The plan is for the provincial steering committees to feed ideas to the Finance Ministry, which would perform a series of financial and economic analyses to rate the project proposals and then submit the ideas for consideration by a centralized steering committee, comprised of GSL officials, representatives from business chambers and NGOs. This is the body that provided the initial inputs for the concept paper.

Likely Areas of Focus

10. (U) Based on our conversations with the Finance Ministry's action officers for MCA, we expect the Government's initial compact proposal to focus primarily on rehabilitating rural irrigation reservoirs - a politically charged issue that was a primary campaign promise of the GSL's Marxist-Nationalist coalition partner the Janatha Vimukthi Peramuna (JVP) - and SME development through firm-level assistance programs. These have been the most consistently mentioned projects by GSL officials and the SME program seems to have the support of the country's primary business chambers.

Outside Involvement in the Consultative Process

11. (SBU) This current round of consultations has been assisted by The Asia Foundation (TAF) and the American Chamber of Commerce (Amcham), though the GSL, after seeking Asia Foundation and Amcham support, has largely run its own process and has sought a much faster timeframe than either Amcham or TAF felt prudent. Both organizations have continued to suggest participants for the consultative process, however.

Comment:

12. (SBU) The GSL resisted initial efforts to channel MCA funds into tsunami reconstruction, which is largely oversubscribed, and has elected to focus on pre-tsunami needs, which should help alleviate inequity between tsunami-related and pre-existing development problems.

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That said, it continues to pursue outreach through an over-centralized, Colombo-driven approach that focuses primarily on GSL-initiatives, rather than potential projects identified through broad-based consultation. The GSL claims it has undertaken consultations through its network of village-level government officials. If this is so, they

need to produce evidence of these consultations and village-level input.

13. (SBU) There is certainly value in focusing on the larger sectors the GSL is interested in - rural development is lagging in Sri Lanka and agricultural productivity is a key problem. Similarly, SMEs face significant structural problems in their efforts to deal with economic challenges, particularly the expiration of the multi-fiber agreement, and its ensuing impact on small and medium sized garment manufacturers and their suppliers. However the GSL has, so far, failed to paint the "bigger picture" of how MCA fits into a larger development plan. This is further hampered by the fact the GSL has rejected the poverty reduction strategy of the previous government, but has yet to present its own alternative, except in the most general terms.

14. (SBU) We have tried many ways to help the GSL better understand the importance to the larger bilateral relationship of taking advantage of the MCA opportunity. We have also tried to get them to think "outside the box" in the development of their proposals. Both issues will become increasingly important given the cuts to USAID funding that have been imposed as a result of Sri Lanka becoming MCA-eligible, despite the lack of any connection between MCA priorities and USAID initiatives (Note: This is in direct contravention to USG statements that MCA funding would be wholly separate from, and would not reduce, other development assistance, an inaccuracy we will need to deal with sooner rather than later should the current allocations prevail. End note). Nonetheless, MCA's new approach and the diversion of the December 26 tsunami has slowed the GSL response and forced them to rethink their standard operating procedures. At this stage, we anticipate a compact proposal sometime before the end of August and we expect it to focus on the two areas outlined above - SME development and the rehabilitation of irrigation reservoirs.

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